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AMEMBASSY PARIS
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AMEMBASSY TEHRAN
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DEPARTMENT OF STATE A/CDC/MR
REVIEWED BY (J) DATE 8/7/81
RDS ☐ or XDS ☐ EXT. DATE
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S E C R E T SECTION 1 OF 2 TRIPOLI 2823

LIMDIS

SUBJECT : NEW RULES FOR THE OIL GAME: THE CASE FOR A BETTER UNDERSTANDING OF WHAT THEY ARE

1. SUMMARY: LIBYA'S TACTICS IN SECURING HIGHER PRICES FOR OIL, AND SPREADING EFFECTS OF ITS SUCCESS, HAVE DRAMATIZED EXTENT OF DEPENDENCE BY OECD COUNTRIES ON OIL IMPORTS AS SOURCE OF ENERGY. NOW THAT EFFECTIVENESS OF RESTRICTING VITAL SUPPLY TO RAISE PRICE HAS BEEN DEMONSTRATED BY LIBYA, LIKELIHOOD THAT MAJOR OIL PRODUCING COUNTRIES WILL BE ABLE TO OVERCOME THEIR DIVISIONS TO COOPERATE IN CONTROLLING PRODUCTION AND RAISING PRICES IS GREATLY INCREASED. I AM CONCERNED THAT US GOVERNMENT, OUR ALLIES AND OIL COMPANIES ARE NO BETTER PREPARED NOW TO DEAL WITH ENHANCED INFLUENCE

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OF PRODUCING COUNTRIES AND PROSPECTIVE DEMANDS FOR ADDITIONAL PRICE INCREASES BY OPEC AND/OR LIBYA THAN THEY WERE A FEW MONTHS AGO. RATIONALE OF THOSE WHO CALL FOR USE OF ARAB OIL AS WEAPON IN MIDDLE EAST CONFLICT ALSO HAS BEEN STRENGTHENED IN PRESENT CIRCUMSTANCES. I BELIEVE CHANGES IN OIL SUPPLY AND PRICE FACTORS SHOULD BE EXAMINED URGENTLY FROM STANDPOINT OF ECONOMIC AND SECURITY REQUIREMENTS OF OECD COUNTRIES. THIS IS NOT AN APPEAL FOR MAINTAINING STATUS QUO BUT RATHER FOR ANALYSIS THAT WOULD INDICATE WHAT OPTIONS MAY BE AVAILABLE AND WOULD SUGGEST LINES OF ACTION OR POLICY ADAPTIONS. END SUMMARY.

2. WE CONCLUDED, AS DID OTHER OBSERVERS, WHILE LIBYAN TAX-PRICE SETTLEMENT WAS TAKING PLACE THREE MONTHS AGO, THAT NEW TERMS FOR PAYMENTS TO GOVERNMENTS WOULD SPREAD RAPIDLY AND CAUSE GENERAL INCREASE IN TAX-PAID COST OF OIL THROUGHOUT MIDDLE EAST AND AFRICA. A COST TO BE BORNE BY CONSUMERS. THIS PROCESS NOW IS WELL ADVANCED, BUT RECENT EVENTS IN LIBYA HAVE HAD ANOTHER AND EVEN MORE PROFOUND RESULT. EXTENT OF DEPENDENCE BY WESTERN INDUSTRIAL SOCIETIES UPON OIL AS A SOURCE OF ENERGY HAS BEEN EXPOSED, AND PRACTICALITY OF CONTROLLING SUPPLY AS MEANS OF EXERTING PRESSURE FOR RAISING PRICE OF OIL HAS BEEN DRAMATICALLY DEMONSTRATED. DANGER IN THIS DEVELOPMENT IS THAT CONTROL OVER AVAILABILITY AND PRICE, WHICH WAS HELD BY MAJOR OIL COMPANIES THROUGH 1950S, WILL BEGIN TO BE EXERCISED BY GOVERNMENTS OF PRODUCING COUNTRIES BEFORE CONSUMING COUNTRIES ARE PREPARED TO DEAL WITH CONSEQUENCES OF THIS BASIC SHIFT.

3. WE HAVE FORESEEN POSSIBILITY, AS HAVE SOME OIL COMPANY EXECUTIVES (E.G. TRIPOLI 2435) THAT LESSONS NOW BEING LEARNED BY OIL PRODUCING COUNTRIES MAY CAUSE THEM TO ASSERT, THROUGH OPEC, ECONOMIC INFLUENCE WHICH IS THEIR THROUGH CONTROL OVER OIL SUPPLIES. THIS HAS BEEN BASIC OPEC OBJECTIVE SINCE ITS FORMULATION IN 1960. OPEC HAS FAILED, THUS FAR, TO REALIZE ITS POTENTIAL INFLUENCE BECAUSE OF DIVERSITY OF INTERESTS AMONG ITS MEMBERS AND MEMBERS' DOUBTS ABOUT THEIR OWN STRENGTH. HOWEVER, LATTER RESTRAINT HAS BEEN UNDERMINED BY LIBYA'S EXAMPLE. WE SHOULD REMEMBER THAT MANY OIL POLICY MAKERS IN GOVERNMENTS OF PRODUCING COUNTRIES DID NOT WITNESS MOSSADEGH'S FAILURE IN IRAN--AS DID MOST SENIOR EXECUTIVES OF MAJOR OIL COMPANIES FOR WHOM THAT EPISODE IS AMONG THEIR PRIMARY PRO-

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FESSIONAL EXPERIENCES. LIBYA'S RECENT SUCCESS, AND ITS SPREADING EFFECTS, THEREFORE IS MORE LIKELY TO GUIDE THINKING OF PRODUCING COUNTRY GOVERNMENTS THAN IS IRAN'S FAILURE OF NEARLY 20 YEARS AGO.

4. CERTAINLY, LIBYA WAS ABLE TO FORCE ITS WILL ON THE OIL COMPANIES BECAUSE OF COMBINATION OF CIRCUMSTANCES. HIGH RATE OF GROWTH IN ENERGY REQUIREMENTS OF DEVELOPED COUNTRIES HAS BEEN EMPHASIZED IN ACCELERATING DEMAND FOR OIL AS A LOWER-COST AND LESS CONTAMINATING FUEL THAN COAL. LOSS OF ONE MILLION BPD OF SHORT-HAUL CRUDE IN MEDITERRANEAN THROUGH CLOSURE OF TAPLINE AND PRODUCTION RATIONING IN LIBYA THUS CAME AT TIME WHEN DEMAND HAD OUTSTRIPPED ALL PROJECTIONS AND CRUDE OIL TRANSPORT CAPACITY WAS (AND IS) STRAINED ALMOST TO ITS LIMIT. THIS WEAKNESS IN OIL SUPPLY SYSTEM, PLUS UNIQUE FACTORS OF A LARGE AND DISPARATE GROUP OF COMPANIES OPERATING IN LIBYA AND LIBYA'S CUSHION OF ACCUMULATED WEALTH, MADE LIBYAN THREAT TO PROHIBIT EXPORTS OF COMPANIES WHICH REFUSED TO MEET ITS PAYMENT TERMS CREDIBLE AND EFFECTIVE. RAPIDITY WITH WHICH HIGHER PAYMENTS HAVE BEEN AGREED TO BY OIL COMPANIES IN OTHER COUNTRIES HAS LED TO CONCLUSION THAT COMPANIES NOW ARE SENSITIVE TO PRICE DEMANDS OF ANY MAJOR PRODUCING COUNTRY.

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LIMDIS

5. RECENT IRANIAN GOVERNMENT STATEMENT, ACCOMPANYING ANNOUNCEMENT OF ITS SETTLEMENT WITH CONSORTIUM, THAT POSTED PRICE FOR LIGHT CRUDE (NOT AFFECTED BY SETTLEMENT) WOULD BE DETERMINED THROUGH OPEC, SUGGESTS OPEC MEETING AT CARACAS NEXT WEEK MAY SEE SERIOUS EFFORT TO UTILIZE STRENGTH OF PETROLEUM PRODUCERS OLIGOPOLY, SINCE IRAN HAS BEEN ONE OF MAJOR PRODUCERS WHICH HAS RESISTED PAST EFFORTS TO CONTROL GROWTH OF SUPPLIES TO INCREASE PRICES. LIBYA'S UNDER SECRETARY OF PETROLEUM HAS CONFIRMED TO US THAT LIBYA WILL PARTICIPATE IN EFFORT TO EFFECT GENERAL PRICE INCREASE THROUGH OPEC BY RESTRICTING SUPPLY. HE MAINTAINS CONSISTENT LARG POSITION THAT TAX AND PRICE INCREASES LIBYA WON IN SEPTEMBER WERE ONLY RECTIFICATION OF PAST INEQUITIES AND THAT LIBYA NOW WILL PROMOTE

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ACTION TO ACHIEVE TRANDITIONAL OPEC GOAL OF INCREASING OIL PRICES. WE ARE CONFIDENT THAT CONFERENCE'S VENEZUELAN HOSTS, WHO LONG HAVE PROMOTED ADOPTION OF PRO-RATIONUCG TO MAINTAIN AND INCREASE OIL PRICES, WILL CONTINUE TO PRESS FOR SUPPLY CONTROLS, AS SUGGESTED IN CARACAS 5399.

3. WHATEVER THE OUTCOME OF OPEC CONFERENCE, DEPENDENCE OF INDUSTRIAL SOCIETIES UPON EXTERNAL SOURCES OF ENERGY AND CONSEQUENTLY THEIR VULNERABILITY, HAS BEEN EXPOSED. I BELIEVE IT WOULD BE HAZARDOUS TO ASSUME OIL PRODUCING COUNTRIES WILL BE UNABLE TO COOPERATE TO TAKE ADVANTAGE OF THIS SITUATION. I AM CONCERNED THAT USG, OUR ALLIES, AND THE OIL COMPANIES ARE NO BETTER PREPARED TO DEAL WITH CHANGED BALANCE OF POWER IN PETROLEUM SUPPLY SITUATION NOW THAN THEY WERE FEW MONTHS AGO. IF WE ARE LUCKY, WE WILL NOT BE CONFRONTED BY UNIFIED DEMAND FROM OIL PRODUCERS JUST YET. HOWEVER, I AM CONFIDENT THAT LIBYA INTENDS TO MAKE ADDITIONAL REVENUE DEMANDS, UNILATERALLY IF NECESSARY, WITHIN NEXT SIX TO NINE MONTHS. I ALSO FEAR THAT WHEN DEMANDS ARE MADE, EUROPEAN OIL SUPPLY SITUATION AND UNITY AMONG COMPANIES WILL BE LITTLE IMPROVED OVER WHAT IT HAS BEEN AND THAT, AGAIN, THERE WILL BE NO APPARENT CHOICE BUT TO YIELD PRESSURE WHETHER DEMANDS COME FROM OPEC COUNTRIES IN UNISON OR FROM LIBYA ALONE. IN SHORT, I BELIEVE PRESENT OIL SUPPLY SITUATION URGENTLY NEEDS TO BE EXAMINED FROM STANDPOINT OF ECONOMIC AND SECURITY REQUIREMENTS OF OECD COUNTRIES--WITH COMMERCIAL INTERESTS OF OIL COMPANIES TO BE CONSIDERED ONLY AFTER POSSIBLE CONFLICTS WITH SUPPLYING COUNTRIES HAVE BEEN STUDIED AND OUR OPTIONS DEFINED. THIS RECOMMENDATION EMPHATICALLY IS NOT AN APPEAL TO SEARCH FOR MEANS FOR MAINTAINING STATUS QUO. LONG-STANDING RELATIONSHIPS IN INTERNATIONAL PETROLEUM INDUSTRY ARE CHANGING AND ARE CAUSING CHANGES IN FORMS GOVERNING THEM. RATHER, I AM PROPOSING THAT CHANGES IN PRODUCER-CONSUMER RELATIONSHIPS BE STUDIED AND THEIR EFFECTS ON NATIONAL U.S. INTERESTS BE ASSESSED--WITH ASSESSMENT TO INDICATE LINES OF ACTION OR POLICY ADAPTIONS.

7. CONTROL OVER FLOW OF RESOURCES HAS BEEN OF STRATEGIC CONCERN THROUGHOUT HOSTORY. ASSERTING CONTROL OVER VITAL SOURCE OF ENERGY WOULD PERMIT MIDDLE EASTERN STATES TO REGAIN POWER POSITION VIS-A-VIS WEST, WHICH THIS AREA LOST LONG AGO. WHILE MY PURPOSE HAS BEEN TO FOCUS ATTENTION ON ECONOMIC

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HAZARDS RESULTING FROM CHANGED OIL SUPPLY SITUATION, THERE ALSO ARE POLITICAL RISKS GENERATED FROM CONFLICT IN MIDDLE EAST. RATIONALE OF THOSE WHO CALL FOR USE OF ARAB OIL AS POLITICAL WEAPON HAS BEEN STRENGTHENED IN PRESENT CIRCUMSTANCES AND MAY PROVE TO HAVE GREATER APPEAL THAN IN PAST -- AT LEAST IN LIBYA. I, THEREFORE, THINK IT IS TIME THAT WE AND OUR EUROPEAN ALLIES ASSESS CONSEQUENCES OF DILUTION OF OUR CONTROL OVER OIL SUPPLIES AND PREPARE TO HEAD OFF OR MAKE ARRANGEMENTS TO BLUNT THEIR IMPACT.

8. I BELIEVE THAT WHAT IS NEEDED IS: FIRST, DEFINITION OF THIS PROBLEM WITHIN U.S. FOREIGN AFFAIRS COMMUNITY; SECONDLY, USG-WIDE ANALYSIS WHICH WOULD DESCRIBE OPTIONS; AND THIRDLY, COORDINATION OF COURSE OF ACTION WITH OUR ALLIES -- PERHAPS THROUGH OECD. ANALYSIS I PROPOSE MAY ONLY DEMONSTRATE THAT THERE IS NO SHORT-TERM SOLUTION AND THAT CONSUMERS MUST PAY WHATEVER PRODUCERS DEMAND. IF THIS IS THE ONLY ANSWER, I BELIEVE USG SHOULD RECOGNIZE IT, SO THAT WE MAY STRUCTURE OUR SUPPLY ARRANGEMENTS AND OUR INTERNATIONAL DEVELOPMENT AND TRADE PREFERENCE POLICIES ACCORDINGLY. GP-3.
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